



2017 Year in Review

ECONOMY & MARKETS: OVERVIEW

Data as at 31 December 2017

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World Indices Wrap Up

FIXED INTEREST	1 YEAR
Bloomberg AusBond Bank Bill Index	1.75%
Bloomberg AusBond Composite 0+ Yr Index	3.66%
Bloomberg Barclays Global Aggregate Bond Index (hedged to AUD)	3.68%
AUSTRALIAN EQUITIES	1 YEAR
S&P/ASX 300 Index (Total Return)	11.94%
S&P/ASX Small Ordinaries Index (Total Return)	20.02%
S&P Australia BMI Value Index (AUD, gross div.)	10.54%
S&P Australia BMI Growth Index (gross div.)	14.62%
GLOBAL EQUITIES	1 YEAR
MSCI World ex Australia Index (net div., AUD)	13.38%
MSCI World ex Australia Index (net div., hedged to AUD)	20.02%
Hedging Premium	6.64%
MSCI World ex Australia Small Cap Index (net div., AUD)	13.43%
MSCI World ex Australia Value Index (net div., AUD)	8.50%
MSCI Emerging Markets Index (net div., AUD)	27.09%
REAL ESTATE	1 YEAR
S&P/ASX 300 A-REIT Index (Total Return)	6.44%
S&P Developed REIT Index (AUD, net div.)	-0.81%
WORLD MARKETS	1 YEAR
S&P 500 Index	12.79%
MSCI UK Index (net div.)	13.22%
MSCI Europe ex UK Index (net div.)	17.41%
Japan Nikkei 225 Average Index (price-only)	14.16%
Shanghai Stock Exchange Composite Index	5.28%
CURRENCIES (RELATIVE TO AUD)	1 YEAR
British Pound	1.42%
Euro	5.52%
Japanese Yen	-3.97%
United States Dollar	-7.51%

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Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Hedging premium – MSCI World ex Australia Index (net div., hedged to AUD) minus MSCI World ex Australia Index (net div., AUD).

KEY THEMES

- Strong performances for global equity markets
- Emerging markets lead gains; best year since 2009
- Strongly positive size premium in Australia
- IMF upgrades global economic outlook
- Term and credit premiums positive in fixed interest

GLOBAL SUMMARY

Global equity markets posted strong performances in 2017, defying expectations among many analysts of a difficult year given the backdrop of major geopolitical events, uncertainty about global economic growth and rising US official interest rates.

Back in January 2017, one media outlet said strategists were more bearish on equities than they had been for any year since 2005.¹ As it turned out, the global economy strengthened through the year and share markets posted solid performances on low volatility.

The mood defied earlier predictions that investors might hold back as the Trump presidency settled in, Brexit negotiations began, tensions rose over North Korea, and elections were held in many nations, including Germany, France, the UK, Japan and New Zealand.

Amid improving signs for the US economy, the Federal Reserve raised interest rates three times in 2017 and projected another three for 2018. Towards year's end, the IMF said a global upswing was strengthening, with growth upgrades for the Euro area, Japan, emerging Asia, emerging Europe and Russia.²

Emerging markets led to gains in global equity markets, their best year since coming out of the global financial crisis. Developed markets also delivered 20%+ returns for the year. In New Zealand, the NZ50 index registered a sixth consecutive year of gains, hitting record highs. Australia's benchmark ASX300 index approached its highest levels in 10 years and within 10% of its October 2007 record highs.

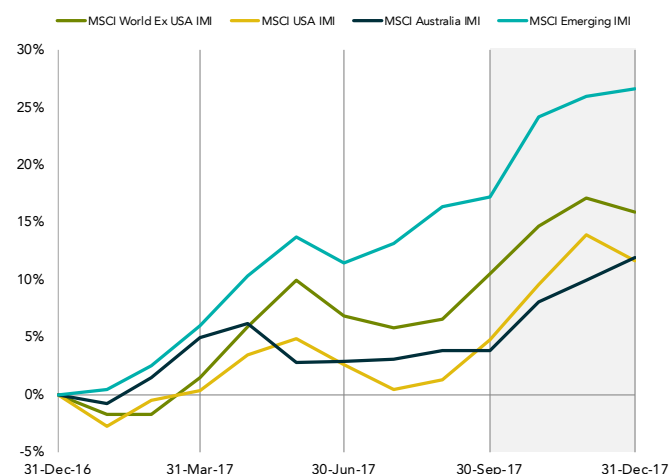
Overall, equity markets were strong, credit spreads narrowed and volatility in financial markets was low. Despite the improvement in the global economy, wage growth and core inflation remained very low in many countries.

The takeout from 2017 is that it makes more sense to employ an investment approach based on diversification and discipline than one based on making predictions and timing markets. After all, this latter approach requires that you not only accurately forecast future events, but also anticipate how markets will react.

1. "Wall Street's 2017 Forecast is the Most Bearish Annual Outlook in 12 years", CNBC, 3 Jan 2017.

2. "World Economic Outlook", Oct 2017, International Monetary Fund.

Global Equity Climate



Performance is shown in AUD and is based on the MSCI World ex USA IMI Index (net div.), MSCI USA IMI Index (net div.), MSCI Australia IMI Index (net div.), and MSCI Emerging Markets IMI Index (net div.). Past performance is not indicative of future results. MSCI data copyright MSCI 2018, all rights reserved. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

EQUITY MARKETS BREAKDOWN

Among developed markets, using the MSCI World Index (IMI) as a proxy, the overall gain for the year was a bit over 13% in AUD terms. All 23 members posted positive returns, ranging from more than 40% in Austria to just under 3% in Israel.

European markets led gains across developed equity markets over the year. Policymakers noted improving sentiment about the earnings outlook, with economic growth in the 19-nation euro zone the strongest in almost seven years and unemployment falling.³

In the US, the benchmark S&P-500's near 22% return in local currency terms was its best calendar year since 2013 and placed 2017 in the top third of best performing calendar years in the index's history.

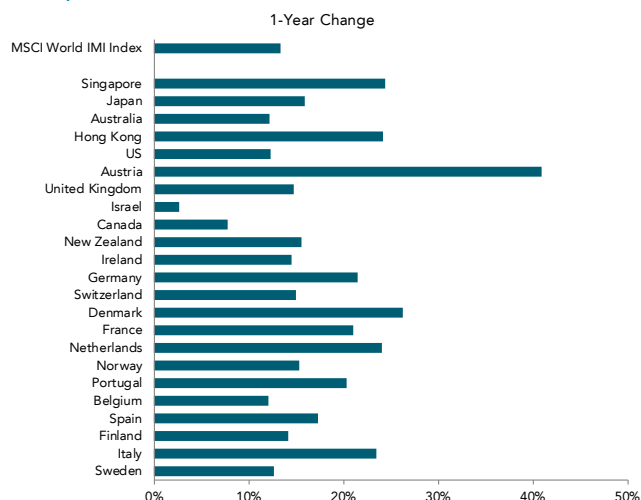
While developed markets performed strongly, they lagged emerging markets. The MSCI Emerging Markets index returned more than 27% over the year, its best performance since 2009. China was one of the top performers, jumping almost 40%.

The premiums were mixed in developed markets outside Australia over the year, with the profitability premium positive, the size premium flat and the value premium negative. In emerging markets, profitability also was positive, but size and value were negative.

With many markets at or near record highs, a common question in the media was whether a downturn was due. However, history tells us that a market index being at an all-time high generally does not provide actionable information for investors.

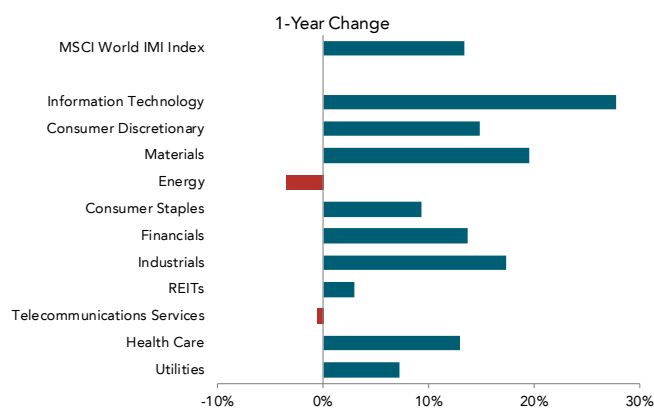
In sectoral terms, information technology stocks, materials and consumer discretionary stocks were among the best performers in both developed and emerging markets.

Developed Country Annual Performance



Countries added to the index throughout the year only show returns for their period of inclusion. Performance is shown in AUD and is based on the MSCI World IMI Index. Past performance is not indicative of future results. MSCI data copyright MSCI 2018, all rights reserved. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Developed Market Sector Returns



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3. "Euro Area Activity Accelerates to Fastest Pace Since Early 2011", Bloomberg, Jan 4, 2018.

AUSTRALIA AND NZ

The Australian share market gained almost 12% in 2017 on a total return basis, its sixth consecutive year of gains and bringing it to its highest levels in nearly a decade.

The best performing sectors for the year were health care, information technology and energy. Telecommunications services was the only sector with negative returns, although this was heavily impacted by the poor performance of Telstra.

Highlighting the importance of diversification across markets, the size premium was strongly positive in Australia, contrasting with its performance offshore. Profitability was positive across the year (although negative in small caps) and value was flat.

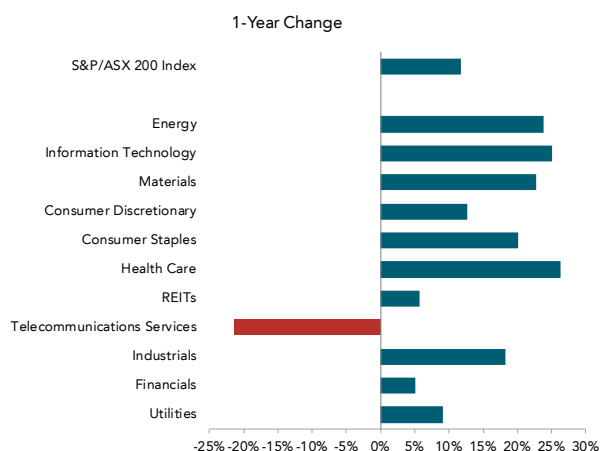
In December, the Reserve Bank of Australia (RBA) said the local economy was growing around its trend rate of 3%, with employment and investment strengthening. Activity was being supported by low interest rates and public investment in infrastructure.⁴

The RBA said one continuing source of uncertainty, however, was the outlook for household spending, with income growth slow and household debt levels remaining high.

The New Zealand share market also posted its sixth consecutive year of gains and its best year since 2012, reaching multiple record highs as the year closed.

In its year-end monetary policy statement, the Reserve Bank of New Zealand noted the strength in the local equity market and projected the economy to strengthen, as positive terms of trade and fiscal stimulus offset a weaker outlook for housing.⁵

Australian Sector Returns



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4. Statement by the Governor, RBA, 5 Dec 2017.

5. Monetary Policy Statement, RBNZ, 9 Nov 2017.

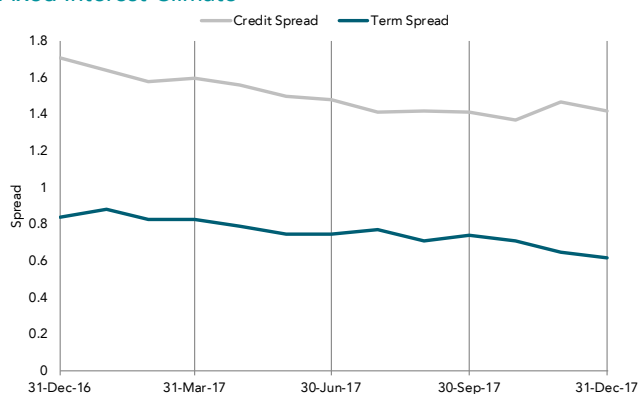
FIXED INTEREST AND CURRENCIES

On fixed interest markets, both term and credit premiums were positive over the year. In other words, longer-term bonds outperformed shorter-term ones, while corporate bonds outperformed government bonds.

On foreign exchange markets, the Australian Dollar was mixed over the year, gaining against the US Dollar, Japanese Yen and NZ Dollar, but falling against the Euro. The NZD made modest gains against the USD, but weakened against most other major currencies.

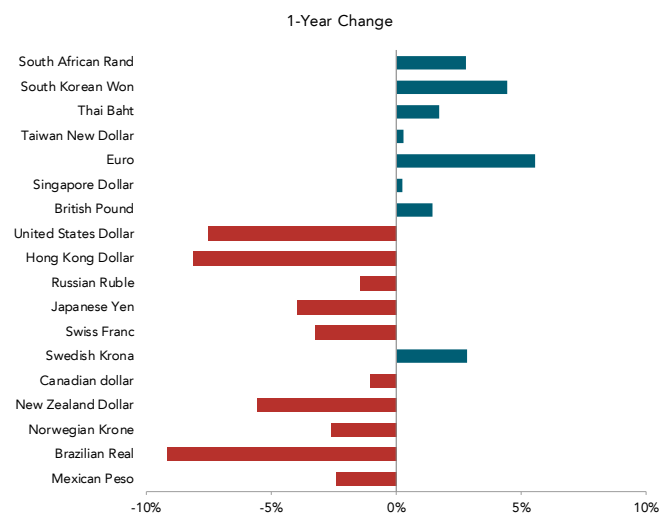
While the US Federal Reserve raised its benchmark rate three times in 2017, both the Reserve Bank of Australia and Reserve Bank of New Zealand left their official cash rates unchanged throughout the year at 1.50% and 1.75% respectively.

Fixed Interest Climate



Credit Spread is defined as Bloomberg Barclays Global Aggregate Corporate Yield to Worst minus Bloomberg Barclays Global Aggregate Treasuries Yield to Worst. Term Spread is defined as Bloomberg Barclays Global Aggregate Yield to Worst minus Bloomberg Barclays Global Aggregate 1 - 3 Year Yield to Worst. Past performance is not indicative of future results. Data provided by Bloomberg. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio.

Currency Movement (Relative to AUD)



Performance is shown in AUD. Currency data provided by WM/Reuters. Past performance is not indicative of future results.

TAKEOUTS

The performance of markets in 2017 underscored once again the dangers of basing one's investment strategy on the news cycle or of acting on opinions and forecasts of media and market pundits.

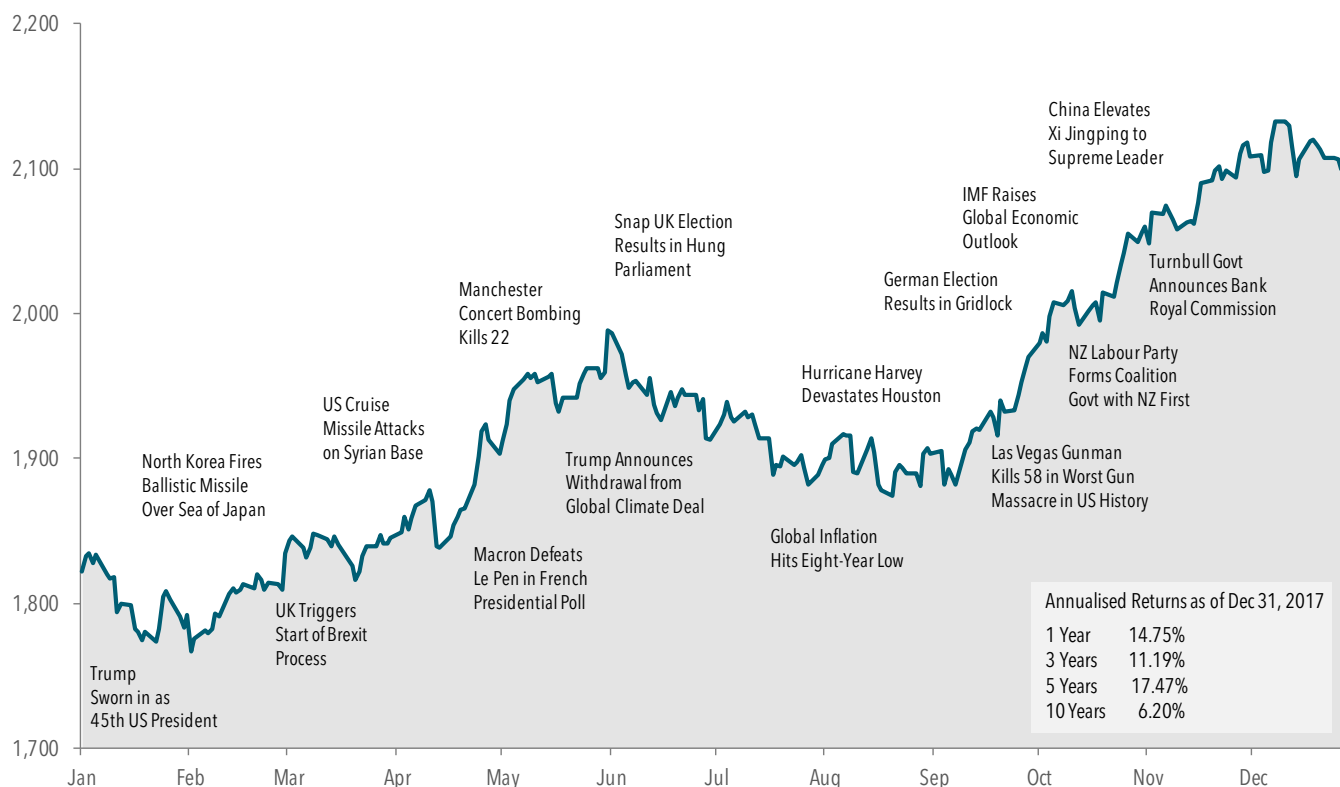
It also highlighted the importance of investors diversifying across different assets and different countries, while staying disciplined within the plan designed for them.

The chart below highlights some of the year's most prominent news events in context of broad market performance, as measured by the MSCI All Country World IMI Index in Australian dollar terms.

By the way, these headlines are not offered to *explain* market returns, but to remind investors of the importance of viewing events from a long-term perspective and to avoid making investment decisions based solely on the news.

World Stock Market Performance

MSCI All Country World Index (IMI) with selected headlines from 2017



Source: Bloomberg.
Returns in AUD, net dividends.